**DEPARTMENT OF STATE REVENUE**
**LETTER OF FINDINGS: 97-0118**
**Indiana Gross Retail Tax**
**For Tax Periods 1993 through 1995**

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## ISSUES

### I. Gross Retail Tax—Uncollectible Receivables ("Bad Debt") Deduction

**Authority**: IC 6-2.5-6-9;
Chrysler Financial Co. v. Ind. Dept. of Revenue, 761 N.E.2d 909 (Ind. Tax Ct. 2002)

Taxpayer maintains it is entitled to a refund of sales tax paid on credit card transactions later found to be uncollectible.

### II. Consumer Use Tax—Store Signage & Point-of-Sale Advertising

**Authority**: IC 6-2.5-3-2

Taxpayer protests a portion of the use tax assessments that were based on Taxpayer's use of store signage and point-of-sale advertising materials in its Indiana stores.

## STATEMENT OF FACTS

Taxpayer operates a nationwide chain of retail stores. A number of these stores are located in Indiana. Taxpayer also is the parent company of a bank ("Bank"), a wholly owned subsidiary, which issues Taxpayer's proprietary credit cards.

Pursuant to a sales and use tax audit, the Indiana Department of State Revenue ("Department") proposed additional assessments of sales and use tax. Taxpayer has protested two of these assessments.

## DISCUSSION

### I. Gross Retail Tax—Uncollectible Receivables ("Bad Debt") Deduction

In addition to its retail activities, Taxpayer is the parent company of a national bank ("Bank"), a wholly owned subsidiary. The Bank issues Taxpayer's proprietary credit cards ("credit cards") to Taxpayer's customers ("customers"). Customers use these credit cards to purchase merchandise at Taxpayer's retail stores. Taxpayer describes its credit sales transactions as follows:

> Simultaneously with the exchange of merchandise between [Taxpayer] and the customer, [Bank] pays [Taxpayer] for all amounts due as a result of the sale. [Taxpayer] collects sales tax on these purchases…and…remits the tax to the Indiana Department of Revenue (Department). … A small percentage of these credit card receivables go uncollected and are written off by [Taxpayer] and taken as a deduction on [Taxpayer's] federal income tax return. [Taxpayer] has an agreement with [Bank] to accept [Bank] issued credit cards and [Taxpayer] also has an ongoing agreement with [Bank] allowing [Taxpayer] to take the bad debt write off amounts as a deduction on [Taxpayer's] Indiana sales tax returns for the above periods.

Audit disallowed the bad debt deduction taken by Taxpayer because the credit card receivables were assets of the Bank and not those of Taxpayer. According to Audit, since Taxpayer assigned its credit card receivables (non-recourse) to the Bank, it is the Bank, and not Taxpayer, that may qualify for a bad debt deduction for federal income tax purposes. Consequently, it is the Bank, and not Taxpayer, that may qualify for the bad debt deduction for Indiana sales tax purposes.

Taxpayer disagrees. Taxpayer contends the assignment of its credit card receivables to the Bank (and the derivative right to the bad debt deduction provided by IC 6-2.5-6-9) should not be a factor in determining which entity is entitled to the bad debt deduction. Taxpayer explains:

> Whether the bad debt is assigned to one party or the other in this case is irrelevant in determining the validity of the deductions since the retailer [Taxpayer] and the retailer's affiliated bank [Bank] file a consolidated federal income tax return and the bad debt is taken as a deduction on that consolidated return.

**Analysis**

The statute entitling a retail merchant to a sales tax deduction for uncollectible receivables (bad debt) provides:

> In determining the amount of state gross retail and use taxes which [] must [be] remit[ted]…a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period,

> an amount equal to his receivables which: (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser; (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and (3) were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

IC 6-2.5-6-9(a).

Indiana case law has extended the reach of IC 6-2.5-6-9 (the "Indiana bad debt deduction"). In addition to retail merchants, assignees also may qualify for this deduction. In Chrysler Financial Co. v. Ind. Dept. of Revenue, 761 N.E.2d 909 (Ind. Tax Ct. 2002), the Indiana Tax Court found that when a retail merchant assigns without recourse an installment contract to a financial institution, the financial institution—as assignee—is entitled to claim the derivative Indiana bad debt deduction.

Taxpayer asks the Department to extend the reach of the bad debt deduction further. Taxpayer insists that once an assigned account receivable has "ripened" into a bad debt for federal income taxpayers, the original assignee (Bank) may re-assign its right to the Indiana bad debt deduction to a related third party—in this instance, to the original assignor (Taxpayer). Taxpayer is mistaken. The original assignee (Bank) may not re-assign its rights to the Indiana bad debt deduction to third parties—related or otherwise.

The assignment of credit card receivables without recourse must be distinguished from the assignment of an Indiana bad debt deduction. In Chrysler, Indiana Chrysler Dealers (Dealers) assigned without recourse "all rights, title, and interest" in their consumer installment contracts to Chrysler Financial (Chrysler). Chrysler at 911. "As consideration for the assignment, Chrysler paid the Dealers all amounts due under the contracts, including the sales tax." Id. At the time of assignment, no bad debt for federal income tax purposes existed; consequently, neither the assignor nor assignee could have claimed or taken an Indiana bad debt deduction. The Dealers did not assign a bad debt. The Dealers did not assign a bad debt deduction. Rather, the Dealers assigned installment contracts. The Dealers assigned "all rights, title, and interest in the contracts without recourse" to Chrysler. Id. Among the rights assigned included the conditional right to an Indiana bad debt deduction.

In effect, Taxpayer argues the Indiana legislature, in drafting IC 6-2.5-6-9, intended to create a transferable refundable "bad debt" sales tax credit. Again, Taxpayer is mistaken.

According to IC 6-2.5-6-9, the amount that may be deducted as bad debt for Indiana sales tax purposes is limited to the amount of receivables "written off as [] uncollectible

debt for federal [income] tax purposes…." IC 6-2.5-6-9(a)(3). The latter is a condition precedent to the former.

In Chrysler, the Indiana Tax Court found that a Dealer may assign its rights to the bad debt deduction. Chrysler at 913. However, from the Court's perspective, Chrysler's right (as assignee) to the bad debt deduction was dependent upon the Dealers' prior assignment of installment contracts to Chrysler. See Chrysler at 913, FN 9. That is, the right to the bad debt deduction *derived from* the assignment of the installment sales contracts. Without the latter, there could be no former.

Taxpayer attempts to detach the realization of bad debt for federal income tax purposes from the recognition of bad debt for Indiana sales tax purposes. This contravenes the language of IC 6-2.5-6-9. Taxpayer attempts to divorce the Indiana sales tax bad debt deduction from the debt instrument itself. This extension of the Tax Court's Chrysler holding is inconsistent with the Tax Court's reasoning. Indiana tax law sanctions neither proposition.

The Department, however, has yet to determine whether the income at issue represented "qualified increased enterprise zone gross income." Once Audit verifies the amount of "qualified increased enterprise zone gross income" to which taxpayer is entitled, this amount, pursuant to IC 6-2.1-3-32, will be excluded from taxpayer's Indiana gross income.

**FINDING**

For the aforementioned reasons, Taxpayer's protest is deniedsustained.

## II. Consumer Use Tax—Store Signage & Point-of-Sale Advertising

Taxpayer purchased store signage and Point-of-Sale ("POS") advertising materials. These items were used in Taxpayer's stores nationwide—including Taxpayer's Indiana stores. Taxpayer paid neither sales nor use tax on many of these items. Consequently, the Audit Division of the Indiana Department of State Revenue ("Audit"), pursuant to IC 6-2.5-3-2, proposed additional assessments of consumer use tax ("use tax").

Due to the number of items involved, Audit used a sampling method to compute the additional assessments. Initially, Audit determined an error percentage from which an estimate of the taxable purchases per store (nationwide) was computed. Audit then multiplied this estimated amount per store by the number of Taxpayer's stores located in Indiana. This product represented the taxable value of store signage and POS advertising materials used in Indiana ("Total Value"). Audit computed the use tax due by multiplying the Total Value by the applicable use tax rate (.05).

Taxpayer agrees with the sampling method used by Audit. However, Taxpayer disagrees with a small portion of the use tax assessments proposed by Audit. Taxpayer explains:

> This protest is due to a computation error in calculating the use tax due of POS signage. The number of stores located in Indiana at each year was overstated.

Taxpayer has provided evidence showing that several of its Indiana stores ceased doing business during the audit period. However, the ***Indiana*** use tax assessments at issue were based on an estimate of the taxable purchases per store ***nationwide***. A decrease in the number of Taxpayer's ***Indiana*** stores does not, without more, lead to the conclusion that the proposed Indiana use tax assessments were overstated. If Taxpayer also experienced a proportional decrease in the number of stores ***nationwide***, the Indiana use tax assessments at issue would remain unchanged.

Taxpayer has failed to provide the Department with sufficient information for the Department to revisit the taxable-purchases-per-store calculus and the resultant Indiana use tax assessments.

## FINDING

Taxpayer's protest is denied.

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